



January 2010

Report to the State of Alaska





ARRC President: A Look Ahead

As stipulated in the Alaska Railroad Corporation Act (AS 42.40), the Alaska Railroad Board of Directors shall adopt a long-range capital improvement and program plan each year and shall forward that plan to the governor and legislature. I am pleased to present our plan for 2010.

ARRC's 2009 business year was a difficult one by any measure. National and international economic decline had a continuing impact on Alaska Railroad business. Our largest revenue customers continued to be markedly down. The overall expense of doing business in Alaska remained high, most notably for fuel and employee medical benefits. From a financial standpoint, unaudited 2009 results forecast total revenues of \$126 million, total expense at \$112 million, yielding a corporate net income of \$14 million. Audited results will true these numbers up by April 1, 2010.

We transported about 5.3 million tons of freight, which represents an annual gross tonnage decrease, primarily due to loss of movement of refined fuel and gravel. Petroleum volume transported from the Flint Hills refinery in North Pole dropped about 12 percent from 2008, the 4th consecutive year of significant decline. Cargo shipped by trailers and containers dipped 3 percent and associated barge-rail tonnage declined 12 percent from 2008.

Export coal was the one revenue bright spot, buoyed by a rise in international demand as well as favorable global coal prices. At 804,000 gross metric tons, 2009 turned out to be the railroad's new record year for export coal. Next year we expect the same or better. In late fall, the railroad started moving returning Stryker vehicles from their overseas deployment location as the Ft. Wainwright 1-25th Stryker Brigade Combat Team comes home. We expect to move 30 of the 18 ton Stryker vehicles per ship over an eleven week period, continuing into 2010.

Alaska Railroad passenger revenue decreased 12 percent reflecting a general decline in leisure travel as a result of the recession. We expect this downward trend to continue into 2010. A recent announcement that a number of cruise ship sailings have been withdrawn in 2010 from the Alaska market supports our assessment.

Consistent with a positive annual trend line, ARRC Real Estate revenue increased 13 percent over 2008 for a total of nearly \$18 million. We attribute growth in real estate revenue to rising land value, higher property occupancy, and the Seward coal loading facility.

This was year number two of our second published 5-Year Plan (2008-2012). The 2009 goal was to hold our own through exceptional expense control to offset more anticipated lost revenue. A sputtering economy continued to drive corporate belt tightening throughout 2009 and revenue declines actually accelerated in the second half. We, in turn, sped up our effort to keep up. We further downsized and re-organized, ultimately positioning the company for what we believe will be an even tougher 2010 business year, a condition which we believe could very likely extend on into 2011 as well. In September we eliminated another 100 funded positions, bringing the total to over 200 for 2008/2009 ... about 25 percent of our workforce. Positions will continue to be reviewed in 2010. In August 2009 we chartered several "Productivity Improvement Teams" to assess processes throughout the Railroad's operations and administrative functions. These teams included across-the-board representation by management as well as by rank and file employees. The cost savings for overall efficiency improvements generated from these teams has been impressive and has contributed significantly to our reduced annual operating expenses. As a result, we believe we are entering 2010 in a stronger corporate position.



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Our capital program, which was the beneficiary of Federal stimulus dollars in 2009, will remain relatively robust. We will continue our bond-financed six-year program (2006 – 2012) to completely refurbish 350 miles of rail, ties, ballast and bridges between Anchorage and Fairbanks.

In the critical area of safety we had another satisfactory year in 2009, with marginal improvements made over the previous good year. More needs to be done in the area of slips and strain incidents. Safety improvements throughout all our operations remains a paramount goal and a target of significant investment dollars. Air quality, lighting, automated tools, personal protective equipment, hearing protection, proper rest, and vehicle operations were all safety areas of emphasis in 2009. Collision Avoidance (AKA “Positive Train Control”) was mandated (unfunded) by Congress for some 30 US railroads to have in place and operating by 2016. The Alaska Railroad will have to nearly double its present \$40 million investment to be in compliance on time with this fully automated track equipment safety initiative, designed to prevent on-track equipment collisions.

We moved quickly and successfully to meet the federal time-line mandates related to the American Recovery and Reinvestment Act 2009 (“ARRA”). Our \$26 million in stimulus funded projects stretched from Seward to Fairbanks and included investment in facilities, tracks, and the collision avoidance system

The single biggest risk to the Alaska Railroad’s business in 2010 remains the viability of the Flint Hills refinery in North Pole. The refinery is at low production levels not seen since the late 1980’s/early 1990’s. At the request of the Alaska Department of Natural Resources, Alaska Railroad looked into the possibility that the State might want to own the North Pole refinery. ARRC concluded that there was significant value added to be had by operating an interior refinery in Alaska, but

the financial risk associated with a State investment of that size was too high and not in the State’s best interest. However, at the same time, ARRC concluded that the State can ill afford the loss of its largest interior refining capability due to the overall economic consequences generated throughout the State if it were to be shut down. Addressing this apparent dilemma, ARRC concluded that the State’s best interests would be served by completely restructuring the Flint Hills-State operating and financial relationship in a way that would permit both parties to accommodate to the volatility present in today’s oil and gas markets, as well as enhance the refinery’s capability to expand its refinery product line. Negative refining margins were completely unforeseen in 2004 when the current royalty contract was let. With a restructured royalty contract as an incentive, Flint Hills would be much more likely to remain in place if it were a more viable operator and could afford to invest in and grow the refinery’s capacity, allowing it to expand to better meet local and international market demands. Refinery business success, in turn, can create income, jobs, and value for the State as well if the agreement is authored correctly, thereby retaining the ability to maximize the overall benefit to Alaskans despite the challenges of Alaska’s unique operating environment.

Payment for most of the railroad’s larger capital projects program comes from highly restricted federal funds (often requiring matching dollars from the Alaska Railroad). In-house capital funding uses the much more flexible and responsive ARRC net earnings to cover dozens of smaller capital improvements and to respond to investment opportunities as soon as the markets present them. In 2009 the Alaska Railroad supported a \$165 million capital budget. The 2009 budget was unusually large due to the \$26 million of Federal stimulus funds from ARRA and a one time appropriation from the Department of Defense of \$60 million for the



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Tanana River access project in support of the Northern Rail Extension program. For 2010, we plan on a \$43.1 million capital budget, on our way to an estimated \$275 million total expenditure over the next five years (2010 through 2014). These “outside” federal dollars come into Alaska and go to good jobs and good Alaskan businesses. Details of our overall program are highlighted in this report. Descriptions of all major railroad capital projects are available at the railroad’s web site — www.AlaskaRailroad.com.

The ARRC business strategy for the next two tough business years is to cut operating costs, aggressively seek out any possible new revenue, and hold on. Until we can forecast an improved Alaska economy and an attendant increase in the Railroad’s bottom line, a forecast which we estimate will need a lead time of at least two years, that’s about the best we can count on. Forecasting beyond two years at this time is rife with speculation and does not have our analytic confidence.

I hope this report provides a useful top line picture of the Alaska Railroad’s medium range financial picture. We would be happy to provide you or your staff with more project information via a detailed ARRC briefing at anytime during your 2010 legislative session. It is the honor of every Alaska Railroad employee to serve this great state.

Warm regards,

Patrick Gamble
President & CEO



BRIDGE AT MILE POST 355.0 SINCE REPLACED WITH CULVERT IN 1991



OLD “STEAMER” TRUNK LOGO CIRCA 1950’S



Mission, Vision and Values

Alaska Railroad Mission

- Safety... Customer Service... Profitability

Alaska Railroad Vision

“Building a great Railroad across the Greatland.”

An important element in fulfilling this vision is ARRC’s success since 1996 in qualifying for federal funding...an entitlement afforded the railroad’s public status and its passenger service mission. As a result, ARRC has been able to greatly accelerate long overdue mainline maintenance and upgrades.

In addition, other federal grants have funded facility improvements, such as inter-modal facilities and docks; technology improvements, such as the collision avoidance system; and homeland security grants. These have come to the the Alaska Railroad via recent major federal legislation.

Alaska Railroad Values

We are a values based organization. Values are all about people, not things. We are all about taking care of our people. We believe who you are is as important as what you do. Character counts. Many of our values are embodied in our corporate Code of Conduct. Our fundamental core values consist of integrity, excellence, and service.

As a responsible partner, in order to accomplish the ambitious goals we set out for ourselves in conjunction with those of others along the railbelt, the ARRC must be a safe, secure, customer responsive, financially and environmentally sound, employee friendly corporation. We must provide a stable, reliable foundation that can be counted on to enhance the future economic growth of the state and the municipalities we support. If our corporate foundation is not sound, support for further state growth and development becomes problematic at best. Values and high standards are the building blocks of that foundation.



TRAIN CREW CIRCA 1950's

DRIVING THE “FIRST” SPIKE APRIL 29, 1915



ORIGINAL ANCHORAGE RAILROAD STATION CIRCA 1930



Alaska Railroad Organizational Chart

Governor • State of Alaska

ARRC Board of Directors

ARRC President & CEO Pat Gamble

**VP Corporate Affairs
Wendy Lindskoog**

**VP Transportation & Mechanical
Pat Shake**

**VP Finance & Chief Financial Officer
Bill O'Leary**

**VP Real Estate & Facilities
Jim Kubitz**

**VP Information, Technology &
Telecommunications Eileen Reilly**

**VP Business Development
Steve Silverstein**

**VP Legal & General Counsel
Phyllis Johnson**

**VP, Engineering & Chief Engineer
Tom Brooks**



Alaska Railroad Quick Facts

Purchase Price (January 5, 1985)

Paid to federal government	\$22.3 million
Start-up costs & contributed capital	<u>\$11.9 million</u>
Total Investment-State of Alaska	\$34.2 million

Organization (following State purchase)

- Independent corporation owned by State
- Managed by a seven-member board of directors. Position qualifications are spelled out in law, members appointed by the Governor.
- Mandated to be self-sustaining, responsible for all its own financial and legal obligations

Financial Statistics

January 1-December 31, 2009* (unaudited)	
Total Assets	\$ 863 million
Total 2009 revenues	\$ 126 million
Total 2009 expenses	\$ 112 million
2009 net income	\$ 14 million
2010 net income budget	\$ 8.4 million

Operating Data

Miles of main line	467
Miles of branch line	54
Miles of yards and sidings	130
Total miles of track	651
Freight cars (owned & leased)	1,160
Passenger cars	47
Locomotives	51

Operating Statistics

January 1-December 31, 2009	
Passenger ridership	470,180 passengers
Freight tonnage	5.4 million tons

Employees (as of January 2010)

Number of year-round employees	657
Average years of service	12.3
Average age	46
Male	541
Female	116

Unions (as of January 2010)

Most of ARRC employees are members in one of five unions:	
United Transportation Union	125
Transportation Communication Union	41
International Association of Machinists	63
American Federation of Govt. Employees	254
American Train Dispatchers Department	8

Benefits

- Corporation provides a defined benefit pension plan
- Corporation provides for health and life insurance
- Corporation provides for retiree medical benefits

* ARRC audits are normally complete by March 31.



Alaska Railroad Mileposts

Each year the Alaska Railroad forecasts its long term objectives and unmet challenges. From this annual analysis, the Alaska Railroad management team establishes an annual rolling 5-year baseline of goals and objectives covering both the short and long terms. At the end of the year, ARRC scores itself against progress made towards meeting these challenges. As objectives are permanently achieved, they are dropped and new ones take their place.

ARRC Five-Year Objectives

- Reduce employee safety incidents to no more than 48 per year.
- Do not add any more at-grade highway/railroad crossings.
- Achieve and sustain an operating ratio of at least .95 by 2011
- Generate and sustain company-wide cash flow, measured as net earnings plus depreciation, of \$39 million per year by 2011.
- Generate and sustain cash flow from real estate activities of \$9 million per year by 2010.
- Maximize return from existing business relationships and seek out new profitable opportunities without sacrificing world class customer service.
- Fully implement Collision Avoidance System technology in 2015.

- Reduce average running time for freight trains between Anchorage and Fairbanks to 11 hours. (Does not include slow orders for natural occurrences)
- Set up an annual programmatic investment plan for ARRC facility infrastructure, including yards and marine facilities, to meet business, growth, employee, and community requirements, as well as energy efficiency goals.
- Ensure ARRC attracts and retains excellent employees by being known as a premier Alaskan employer and by continuously improving our employee training working environment, remuneration, and benefits.
- Build the bridge across the Tanana River.
- Extend the rail line to Delta Junction.
- Complete the accelerated Track Rehabilitation Program plan by 2012.
- Begin local DMU transit demonstration service of some kind in or around Anchorage-Wasilla-Gridwood.
- Continue to enhance environmental stewardship through wise business decisions, to include maintaining Green Star standards.

Five-Year Forecast — Capital Budget

<i>(in millions)</i>	2010 Budget	2011 Plan	2012 Plan	2013 Plan	2014 Plan	TOTAL
Federal Transit Administration Formula Funds	\$ 14.3	\$ 16.0	\$ 17.2	\$ 18.4	\$ 19.7	\$ 85.6
FTA Bond Proceeds - 2007 Issue	9.7	21.4	12.3	—	—	43.4
Federal Stimulus	—	—	—	—	—	—
Other Federal (FHWA/ DoD, FEMA, etc.)	—	38.0	—	—	—	38.0
Internal Funds	16.3	20.1	22.0	22.7	24.7	105.8
Debt Financed Real Estate Projects	2.8	—	—	—	—	2.8
Total Capital Budget	\$ 43.1	\$ 95.5	\$ 51.5	\$ 41.1	\$ 44.4	\$ 275.6

Five-Year Forecast — Operating Budget

<i>(in millions)</i>	2010 Budget	2011 Plan	2012 Plan	2013 Plan	2014 Plan	TOTAL
Net Operating Income	\$ 0.2	\$ 4.0	\$ 4.4	\$ 4.6	\$ 4.7	\$ 17.9
Net Income-Real Estate	9.4	9.9	10.3	11.4	12.1	53.1
Net Other Income (Expense)	(1.2)	(1.1)	(0.9)	(0.8)	(0.6)	(4.6)
Net Income	\$ 8.4	\$ 12.8	\$ 13.8	\$ 15.2	\$ 16.2	\$ 66.4

Five-Year Capital Project Plan-Internal Funding

	2010 Budget	2011 Plan	2012 Plan	2013 Plan	2014 Plan	TOTAL
Nondiscretionary Projects	\$ 13,762,958	\$ 11,368,378	\$ 10,577,417	\$ 14,029,413	\$ 15,580,477	\$ 65,318,643
Continuing Program Projects	\$ 2,312,950	5,592,009	5,700,000	5,011,500	5,130,500	\$23,746,959
Strategic Business Initiatives	\$ 236,100	1,539,125	2,875,000	275,000	275,000	\$5,200,225
Ranked Projects	\$ —	1,629,489	2,837,981	3,414,998	3,691,273	11,573,741
Total - Internal Funding	\$ 16,312,008	\$ 20,129,001	\$ 21,990,398	\$22,730,911	\$ 24,677,250	\$ 105,839,568

Five-Year Capital Project Plan — Debt Financed Real Estate Projects

	2010	2011	2012	2013	2014	TOTAL
Acquire Gillman Property - Whittier	800,000	—	—	—	—	800,000
Freight Shed Tenant Improvements	2,000,000	—	—	—	—	2,000,000
<i>Total-Debt Financed Real Estate Projects</i>	<i>2,800,000</i>	<i>—</i>	<i>—</i>	<i>—</i>	<i>—</i>	<i>2,800,000</i>

Five-Year Capital Project Plan — Federal and Bond Funding

Federal Transit Administration

Passenger Equipment: Rehabilitation	535,558	419,200	500,000	450,000	500,000	2,404,758
Track Projects:						
Depot Improvements	—	400,000	450,000	—	300,000	1,150,000
Track Rehabilitation	7,581,900	9,719,413	11,404,587	13,071,399	13,197,387	54,974,686
Siding Extensions/Shoulder Widening	198,142	—	—	—	—	198,142
<i>Track Project Subtotal</i>	<i>7,780,042</i>	<i>10,119,413</i>	<i>11,854,587</i>	<i>13,071,399</i>	<i>13,497,387</i>	<i>56,322,828</i>
Bridge Replacements/Upgrades:						
Bridge at Mile Post 25.7 Lower Trail Lake	—	—	—	100,000	300,000	400,000
Bridge at Mile Post 29.5 Trail Lake	600,000	378,980	—	—	—	978,980
Bridge at Mile Post 89 Indian	140,000	1,490,000	—	—	—	1,630,000
Bridge at Mile Post 199 Kashwitna River	—	—	—	—	452,000	452,000
Bridge at Mile Post 352.7 Sheep Creek	—	—	—	600,000	—	600,000
Bridge at Mile Post 422.9 Little Goldstream	—	600,000	—	—	—	600,000
Bridge 447.7 Permafrost Bridge	—	—	100,000	600,000	750,000	1,450,000
<i>Bridge Program Subtotal</i>	<i>740,000</i>	<i>2,468,980</i>	<i>100,000</i>	<i>1,300,000</i>	<i>1,502,000</i>	<i>6,110,980</i>

Five-Year Capital Project Plan — Federal and Bond Funding (continued)

	2010	2011	2012	2013	2014	
FTA... continued						
Debt Service Subtotal:						
2006 Bond Issue Debt Service	7,532,160	7,301,371	7,275,940	7,282,763	7,266,964	36,659,197
2007 Bond Issue Debt Service	<u>9,165,184</u>	<u>8,913,501</u>	<u>8,891,659</u>	<u>8,896,554</u>	<u>8,856,361</u>	<u>44,723,259</u>
Debt Service Subtotal	<u>16,697,344</u>	<u>16,214,872</u>	<u>16,167,599</u>	<u>16,179,317</u>	<u>16,123,325</u>	<u>81,382,456</u>
Preventive / Safety / Security:						
Preventive Maintenance Reimbursement	11,110,275	11,165,826	11,277,484	11,390,259	11,504,162	56,448,006
Slope Stabilization/Healy Canyon	1,500,000	950,000	800,000	300,000	800,000	4,350,000
Collision Avoidance-Phase II Completion	3,275,899	1,550,000	3,475,270	2,809,213	2,938,319	14,048,701
Transit Enhancements	217,581	224,109	230,832	237,757	244,890	1,155,169
Transit Security	<u>217,581</u>	<u>224,109</u>	<u>230,832</u>	<u>237,757</u>	<u>244,890</u>	<u>1,155,169</u>
Preventive/Safety/Security Subtotal	<u>16,321,336</u>	<u>14,114,044</u>	<u>16,014,418</u>	<u>14,974,986</u>	<u>15,732,261</u>	<u>77,157,045</u>
Total Federal Transit Administration	42,074,280	43,336,508	44,636,604	45,975,702	47,354,973	223,378,067
Less: Preventive Maintenance Reimbursement	(11,110,275)	(11,165,826)	(11,027,484)	(11,369,259)	(11,504,162)	(56,448,006)
Less: Debt Service Grants	<u>(16,697,344)</u>	<u>(16,214,872)</u>	<u>(16,167,599)</u>	<u>(16,179,317)</u>	<u>(16,123,325)</u>	<u>(81,382,456)</u>
Total FTA for Federal Capital Projects	14,266,661	15,955,811	17,191,521	18,406,126	19,727,486	85,547,605
FTA Capital Grant Receipts Bonds						
Track Rehabilitation Program	9,724,560	21,435,349	12,271,205	—	—	43,431,115
Other Federal Funds						
Tanana River Training-Fund Source Unidentified	—	38,000,000	—	—	—	38,000,000